Distr.
GENERAL

UNCTAD/ECDC/242
22 June 1994
Original: English
English and French only

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

ANALYSIS OF TRADE AND TRADE STRATEGIES AMONG DEVELOPING COUNTRIES

with a view to identifying potential areas of trade expansion and promoting and facilitating current trade among developing countries

Prepared by UNCTAD secretariat for the second session of the Standing Committee on Economic Cooperation among Developing Countries

GE.94-52693

Contents

	Paragraphs
List of tables	
Abbreviations	
I. INTRODUCTION AND SUMMARY	1 - 17
II. TRADE AMONG DEVELOPING COUNTRIES	19 - 35
A. Trade among developing countries in world trade	19 - 22
B. Intra-regional and inter-regional trade among developing countries	23 - 27
C. Intra-grouping trade among developing countries	28 - 32
D. Conclusion	33 - 35
III. DEVELOPMENT THROUGH TRADE	36 - 58
A. Export-led growth in a theoretical and historical perspective	36 - 45
B. Cross-country comparison regarding export and development	46 - 52
C. Export growth and diversification	53 - 56
D. Conclusion	57 - 58
IV. SOME MAJOR ISSUES ON TRADE AMONG DEVELOPING COUNTRIES AND POLICY IMPLICATIONS	59 - 93
A. Product structure and the lack of diversity	59 - 66
B. Some theoretical issues of trade integration: Trade creation and diversion versus dynamic effects	67 - 77
C. Unbalanced benefits from integration, multi-track liberalization programmes and compensation scheme	78 - 84
D. Implementation problem: Political factors and institutional aspects	85 - 93
V. PROSPECTS FOR SUCCESSFUL TRADE COOPERATION AND INTEGRATION	94 - 117
A. Integration of small and homogeneous countries	95 - 99
B. Cooperation of small countries with a dominant economy	100 - 102
C. Integration among diversified countries	103 - 110
D. Cooperation in a wider and looser framework	111 - 116
E. Policy instruments	117
Annexes	
I. Regional economic integration/cooperation: Policy instruments	
II. A case study: Reforms in Indonesia	
III. Statistical annex	
A. Intra-regional and inter-regional trade, total trade	
B. Intra-regional and inter-regional trade, trade in manufacturing	
C. Growth, trade and diversification	

List of Tables

Table 1 Envisaged form of regional cooperation among developing countries
Table 2 Share of intra-regional trade in total trade of the region
Table 3 Coefficient of trade intensity for goods in all categories
Table 4 Coefficient of trade intensity for manufacturing sector
Table 5 Intra-grouping trade
Table 6 Growth of GDP and exports of selected countries during the 1980s
Table 7 Major export products of selected countries and groupings: (1) West Asia and North Africa
Table 8 Major export products of selected countries and groupings: (2) Sub-Saharan Africa
Table 9 Major export products of selected countries and groupings: (3) Latin America
Table 10 Major export products of selected countries and groupings: (4) South and South-East Asia
Table 11 Coffee: Price and export quantity in the world
Table 12 Effects of trade integration: Static and dynamic effects

Abbreviations

AFTA	ASEAN Free Trade Area
AMU	Arab Maghreb Union
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
CACM	Central American Common Market
CARICOM	Caribbean Common Market
CARIFTA	Caribbean Free Trade Area
CEAO	West African Economic Community
CEPGL	Economic Community of Great Lakes Countries
CET	common external tariff
EAC	East African Community
EC	European Community
ECCAS	Economic Community of Central African States
ECO	Economic Cooperation Organization
ECOWAS	Economic Community of West African States
EU	European Union
FDI	foreign direct investment
FTA	free trade area
LAFTA	Latin American Free Trade Area
LAIA	Latin American Integration Association
LAS	League of Arab States
MERCOSUR	Southern Cone Common Market
MARIUN	Mano River Union
NAFTA	North American Free Trade Area
NICs	newly industrializing countries
OAS	Organisation of American States
OAU	Organisation of African Unity
OECM	Organisation of East Caribbean States
PTA	Preferential Trade Area for Eastern and Southern African States
SAARC	South Asian Association for Regional Cooperation
SADC	Southern African Development Community
UDEAC	Central African Customs and Economic Union

I. INTRODUCTION AND SUMMARY

1. Since 1990, interest in economic integration among developing countries seems to have been gathering strength. Many economic integration groupings of developing countries have been revising their strategies (see table 1)[1] to reinvigorate the process of economic integration and to widen the range of economic cooperation - not only in trade integration but also in infrastructure development, industrial cooperation, investment-policy coordination, human-resources development, etc.

2. This revival of interest reflects several factors, both internal and external to the developing countries. In the countries of Latin America, the severe external debt problem that plagued many countries throughout the 1980's seems to be easing, relieving them from the urgency of earning hard currencies, that is of trading mostly with developed countries. At the same time, most developed countries are undergoing prolonged recession, and thus not inspiring much hope for any immediate increase in import demand from developing countries. Hence trade exchanges with other developing countries offer a dynamic alternative. The effect of the end of the Cold War has also spilled over to the economic front; in trade policies and in foreign aid, the emphasis has shifted away from largely geo-political concerns to mostly geo-economic considerations, as evidenced by the formation of "regional blocs".

3. Change is also evident in the thinking of economists and policy-makers. The unfettered liberal economic philosophy of the 1980s has been under pressure. The structural adjustment programmes that flourished among developing countries during the 1980s are proving to be double edged - while the programmes seemed to have successfully prepared some developing economies for global competition, their hasty, generalized application may have left others very vulnerable to outside competition. This is especially so where countries lack strong export capabilities or balanced industrial growth to accompany their trade liberalization. Regional cooperation is pursued for the possibilities which it seems to offer as a way to gain competitiveness.

4. This paper attempts to analyse the significance of these new developments and to indicate the new dimensions in economic thinking on trade cooperation among developing countries, particularly in comparison with the conventional ideas that formed the basis for the first wave of economic integration during the 1960s and early 1970s.

5. Economic integration among developing countries flourished in the 1960s, first in Latin America and then in Africa and the Caribbean (LAFTA and CACM were established in 1960, UDEAC in 1969, CARIFTA in 1968, the Andean Group in 1969, ECOWAS in 1975). This trend reflected the thinking of the day on economic integration among developing countries as the middle-of-the-road path to development between an import-substitution policy at the country level on one side and a free-trade policy with developed countries on the other. Country-level import substitution was increasingly seen as a failing policy because of the smallness of most developing economies and the inefficiencies arising from largely monopolistic structures. Free trade with developed countries was considered: (a) to restrict developing countries to specialization in the primary sector, in which they had comparative advantages; and (b) to invite capital flight, for example in the form of abnormally high corporate profits of dominating multinationals from industrialized countries.

6. Formation of integration groupings, particularly in Latin America, had an immediate impact on increasing intra-grouping trade. The following quotation with regard to CACM, written in 1973, typifies the evaluation of economic integration among developing countries in the early 1970s;

> The experience of Central America shows that, under appropriate

---

[1] Various forms of regional integration are explained in annex I.

Table 1 Envisaged form of regional cooperation among developing countries

Envisaged Form of Regional Cooperation	Groupings
Preferential Trade Area	- Latin American Integration Association (LAIA) - South Asian Association for Regional Cooperation (SAARC) - Bangkok Agreement
Free Trade Area	- Economic Community of Great Lakes Countries (CEPGL) - Economic Community of West African States (ECOWAS) - West African Economic Community (CEAO) - ASEAN Free Trade Area (AFTA) - Economic Cooperation Organization (ECO)
Customs Union	- Central African Customs and Economic Union (UDEAC) - Economic Community of Central African States (ECCAS) - Mano River Union (MRU) - the Andean Group - Central American Common Market (CACM)
Common Market	- Arab Maghreb Union (AMU) - Preferential Trade Area for Eastern and South African States (PTA) - Caribbean Common Market (CARICOM) - Organization of East Caribbean States (OECM) - Southern Cone Common Market (MERCOSUR) - Gulf Cooperation Council (GCC)

> circumstances, the elimination of restrictions on the mutual trade of a group of developing countries brings about considerable expansion in their commercial interchange, fuller use of industrial capacity, specialisation of production, economies of scale, increased industrialisation and faster economic growth, without any rise in the number of industrial failures or in the amount of unemployment.[2]

7. The rise in intra-grouping trade, however, began to sputter during the late 1970s. Around 1980, the intra-trade of many economic groupings had either started to stagnate or, even worse, to drop at an increasing speed. This trend continued until around 1986. The turnaround was particularly evident in Latin America, where many countries were suffering from the worsening of their external debt positions. In Africa, any hope of raising intra-grouping trade seemed to be dashed by the persistently low figures of trade throughout the continent. During this period, the only region with a clear record of growth was South-East Asia, where ironically integration efforts were least evident.

8. The contrast may be clearly seen in Chart 1, which depicts the trend in intra-grouping trade for CACM and ASEAN. CACM had been considered one of the most successful examples of regional integration (see paragraph 6); it has remained responsible for a respectable amount of intra-trade compared to most other groupings.[3] Yet stagnation is evident.

9. In the conventional thinking, CACM should have been the ideal candidate

---

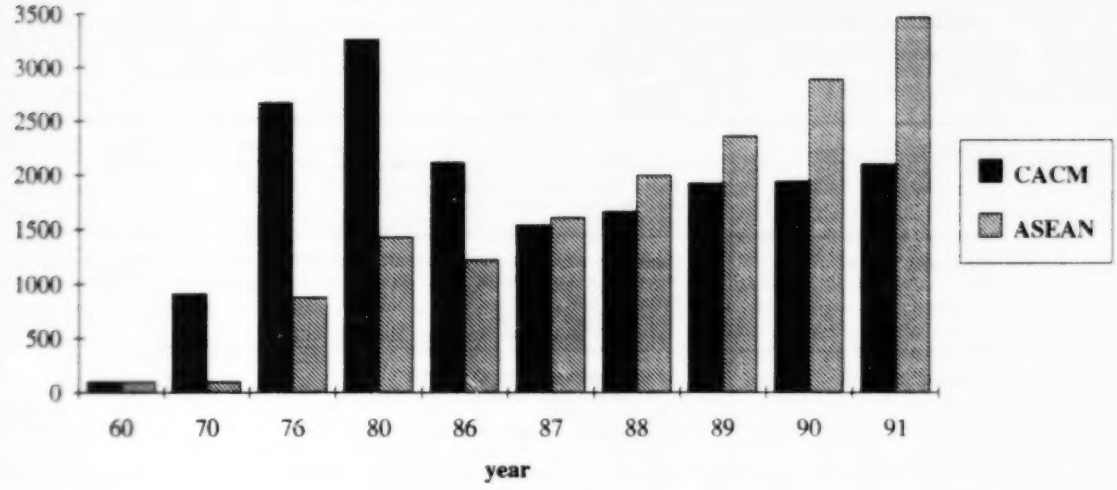
[2] F. Pazos (1973), "Regional Integration of Trade among Less Developed Countries," *World Development 1*. Also see D. Morawetz (1974), *The Andean Group: A Case Study in Economic Integration Among Developing Countries*, (Cambridge, Massachusetts, MIT Press).

[3] For CACM, the share of intra-grouping trade in its total exports was around 15 to 16 per cent during the period of 1989 to 1991 (UNCTAD, *Handbook of International Trade and Development Statistics, 1992*).

Chart 1

Trend in intra-grouping trade: CACM and ASEAN

(Value index, 1960 = 100)



for a successful integration since: (i) being a group of small countries, it can fully benefit from integration through the virtue of scale economies; and, (ii) being a group of relatively homogeneous countries, it should be free from the most perilous problem of "unequal benefits" from the integration.

10. In contrast, countries in ASEAN are generally larger and much more diverse than those in CACM. Moreover the political process leading towards integration seems much slower and the approach more cautious in ASEAN than in CACM.[4] Still, contrary to what conventional wisdom would lead one to expect, ASEAN has increased intra-grouping trade more than any other grouping[5]. One objective of this study is to seek to discover the reason for the difference, and to ask how the conventional thinking can be readjusted so as to develop new ideas that will serve as a policy guide during the new wave of economic integration.

11. In section II, the current situation of trade among developing countries is examined and analysed. Trade among developing countries, with the exception of inter-regional trade, has ben found to be more intensive than its absolute low level would imply. For example, intra-grouping trade among CACM countries, which accounts for 15.6 per cent of CACM's total exports, may be considered low. It is not growing as expected. However, such trade is definitely higher than the share of CACM as an export destination in the world

---

[4] It is only recently that ASEAN has pledged to go into a stronger form of free trade area integration.

[5] For ASEAN, the share of intra-grouping trade in its total exports has been just below 20 per cent in recent years (UNCTAD, *Handbook of International Trade and Development Statistics, 1992*).

average, which stands at a dismal 0.18 per cent. This suggests that intra-regional or intra-grouping trade is low because of the absolute low levels of trade of these countries, not because intra-regional trade liberalization has been unsuccessful. The policy emphasis should be placed on the promotion of industries that produce exportable goods and enhance economic development.

12. Following the presentation of this finding, the relationship between economic development and export expansion is examined, in section III, through historical examples as well as statistical analysis of current developing countries. Two major conclusions emerge. First, export growth becomes an engine of economic development when industrial structure is "right" or *growth-inducing*. What this implies can vary among countries because of differences in their social and economic conditions; what is right also changes over time. The right policy does mean fostering industries that will bring the country one step closer to social, economic and technological development. Secondly, the diversification of export structure has been found to be important for export growth.

13. Section IV is devoted to some key issues surrounding trade cooperation among developing countries. First, on the basis of the findings presented in section III, the current positions of developing countries and economic groupings with respect to production structures and diversification are examined, and their policy implications discussed. Facilitation of growth-inducing industries and diversification of production structure were found to be very much needed. Regional cooperation on this aspect was considered essential to an effective strategy because of the similarity of the export structure of much of the relatively underdeveloped countries and regions.

14. Subsequently, some theoretical issues of economic integration are discussed, in particular on Vinerian trade creation and diversion effects (see note 17). It is argued that, for trade integration among developing countries, trade creation and diversion effects, while not entirely negligible, tend to play only a minor role in practical policy-making situations.

15. The third issue discussed is the imbalance among member countries in the costs and benefits of economic integration. Some policy considerations are set out regarding measures to mitigate the problem of imbalance, such as multi-track liberalization, compensation schemes and development funds.

16. Finally, the problems of policy implementation are discussed; some studies from recent literature are brought to bear on this issue. It is argued that there are two types of implementation problems: political problems which often manifest themselves during the adoption process of policy packages; and implementation problems which arise from the incapability of the public administration apparatus. It has been suggested that the policy choice should reflect the situation in the country with respect to these two factors. The concept of "institution-light" and "institution-heavy" policies is introduced to serve as a conceptual guideline for evaluating policy packages.

17. Furthermore, the impact of external political factors forming a major hinderance to the implementation of cooperative policies is considered. In some cases, when Governments face uncertainties in external political relationships, economic cooperation policies have been used as a means arbitrarily to reward or punish the behaviour of other Governments. In such cases, the resulting lack of consistency in cooperation policy has been a major hinderance to the healthy development of intra-regional trade. One possible suggestion to mitigate the impact of policy arbitrariness is to foster the domestic private sector and promote private-sector cooperation among the countries concerned.

18. Section V considers how these issues relate to actual policies of regional cooperation, given the differences in economic characteristics of regional groupings. Policy priorities and expectations will rightly differ depending on the economic characteristics of the groupings concerned. The more alike the countries in an economic grouping and the more underdeveloped

are they (e.g. CACM), the more the emphasis must be put on utilization of scale economies and policies that facilitate economic development. For such groupings, a "stronger" form of integration is recommended. Conversely, the more diversified the groupings (e.g. ASEAN) the more reason to take a cautious approach to integration, because of the imbalance problem, and to consider ways to promote inter-linkages of industries (e.g through policies that facilitate vertical integration) in order to exploit to the fullest the differences and economic complementarities. Finally, for some other groupings, it has been suggested that a looser approach be considered, not aiming at deep economic integration for practical reasons, but rather attempting to provide a venue for policy consultations, communications and exchange of national experiences.

II. TRADE AMONG DEVELOPING COUNTRIES

A. Trade among developing countries in world trade

19. Since around 1986, trade among developing countries has been in a recovery phase, recovering process from the slump of the early the 1980s.[6] This is mostly owing to the rapid economic expansion in the South to East Asia region where intra-regional trade, along with total trade, has been rising at a remarkable pace. Contributing to this recovery was the easing of the massive foreign debt problem in Latin America, where countries are gradually obtaining some relief from the urgency of earning hard currencies through trading with developed countries. In other regions, however, stagnation seems to be continuing, but the situation differs from one country to another.

20. In 1991, world trade was still dominated by trade among developed market economy countries, which accounted for 55 per cent of total world trade.

Table 2 Share of intra-regional trade in total trade of the region

	DMEC	SESC	Developing countries					
			Total	Am.	Af.	WA	SSEA	Oc.
1970	62.8	n.a.	10.8	9.2	2.9	4.6	10.0	2.9
1980	52.3	n.a.	15.7	10.9	1.7	3.8	11.4	1.7
1986	63.0	n.a.	15.9	8.8	2.7	7.8	10.9	2.7
1987	63.7	n.a.	15.0	7.4	2.7	7.4	11.5	2.8
1988	63.2	35.4	15.5	7.0	2.8	7.1	12.3	2.3
1989	62.6	29.7	15.8	8.1	3.1	6.8	12.8	2.4
1990	63.6	22.4	15.7	7.3	2.7	6.6	13.9	1.8
1991	62.0	18.6	16.7	8.0	2.7	5.6	14.7	n.a.

DMEC = Developed market economy countries
SESC = Socialist and Ex-socialist Countries in Asia and Eastern Europe
Am. = America
Af. = Africa
WA = West Asia
SSEA = South and South-East Asia
Oc. = Oceania

Total Trade = Intra-regional trade + Exports to outside the region + Imports from the outside of the region

[6] All the figures in this section, unless otherwise noted, are derived from tables A and B in annex III.

Intra-developing country trade accounted for only 6 per cent, and trade between developing and developed countries for 27 per cent. Within the trade to and from developing countries, trade with developed countries dominated at 72 per cent, while trade among developing countries accounted for only 17 per cent.[7]

21. The low figures of intra-developing trade in the *absolute* level, however, may be the reflection of the smallness of their economies rather than the weakness of their trade relationships. While trade among developing countries accounts for only 17 per cent of their foreign trade, the share of developing countries in the world GDP is also around 18 per cent.

22. To be more precise, let us compare trade among developing countries against the levels of their overall exports and imports. The share of developing countries in world exports was 21.4 per cent, and the share in imports was 22.7 per cent. If all the countries were to trade with each other in exactly the same proportion, the share of trade among developing countries should have been 4.8 per cent (i.e., 21.4 per cent times 22.7 per cent)[8] of the world trade. The actual intra-developing country trade was higher at 6.3 per cent, implying that developing countries traded among each other relatively intensively compared to their overall size of imports and exports. What is keeping intra-developing country trade low is *not* that developing countries do not trade each other, *but* that their absolute amount of trade is small - whether it is with developing or developed countries. In other words, their volume of trade is small and underdeveloped.

B. Intra-regional and inter-regional trade among developing countries

23. Tables A and B in annex III also report all the intra- and inter-

Table 3 Coefficient of trade intensity for goods in all categories

(1991)

to	DMEC	SESC	Developing countries					
from			Total	Am.	Af.	WA	SSEA	Oc.
DMEC	0.03	-0.24	-0.06	0.00	-0.01	-0.02	-0.10	0.01
SESC	-0.24	0.69	0.12	0.02	-0.13	-0.09	0.19	-2.11
Developing countries								
Total	-0.06	0.06	0.11	0.01	0.07	0.09	0.17	0.09
Am.	-0.06	-0.09	0.01	0.55	-0.24	-0.27	-0.45	-0.70
Af.	0.06	-0.22	-0.23	-0.71	0.41	-0.10	-0.63	-1.20
WA	-0.07	-0.35	0.20	-0.24	0.42	0.54	0.11	-0.40
SSEA	-0.08	0.17	0.16	-0.34	-0.07	-0.01	0.32	0.23
Oc.	0.04	-0.48	-0.11	-1.56	-1.89	-2.04	0.04	1.49

For the abbreviations of the regions' names, see table 2 above.

[7] The remaining portions of the world trade and the developing-country trade are accounted for by trade with socialist and ex-socialist countries and statistical residuals.

[8] Exports from developing countries account for 21.4 per cent, of which 22.7 per cent should go to developing countries according to this hypothesis. Thus, the hypothetical share of intra-developing country trade is 21.4 times 22.7 per cent.

Table 4 Coefficient of trade intensity for manufacturing sector

(1990)

to	DMEC	SESC	Developing countries					
from			Total	Am.	Af.	WA	SSEA	Oc.
DMEC	0.03	-0.27	-0.05	0.00	0.01	-0.02	-0.09	0.00
SESC	-0.41	0.83	0.21	0.00	-0.07	-0.05	0.33	-2.10
Developing countries								
Total	-0.06	0.16	0.12	-0.22	-1.04	-1.24	-1.26	-1.45
Am.	-0.04	-0.52	0.17	0.70	-0.09	-0.28	-0.30	-0.48
Af.	-0.02	-0.04	-0.07	-0.74	0.73	0.31	-0.33	-1.13
WA	-0.15	-0 33	0.23	-1.26	0.31	0.91	-0.19	-1.13
SSEA	-0.06	0.15	0.12	-0.34	-0.16	-0.05	0.28	0.15
Oc.	-0.03	-1.46	0.12	-1.34	n.a.	n.a.	0.13	1.98

For the abbreviations of the regions' names, see table 2 above.

Manufacturing sector = SITC 5 + 6 + 7 + 8 - 68

regional trade flows. These figures are not directly comparable between different regions because of the size differences. To separate the "size" factor and the level of "trade intensity", a trade intensity coefficient was calculated (see tables 3 and 4 of the text). This coefficient measures the hypothetical "distance" between the trade origin and destination in terms of their trade relationship in an analogy to the gravity model (with the trade flow being analogous to the strength of the gravity pull and the sizes of the economies to the masses of the objects).[9] For each trade flow, if the coefficient is positive (negative), the trade relation is stronger (weaker) in comparison with the sizes of imports and exports of the destination and origin.

24. The coefficients in table 3 show that, compared to their size, trade relations among developing countries are relatively strong within each region. The same applies also to the coefficients calculated for the manufacturing sector (table 4). It implies again that the absolute level of intra-regional trade among developing countries is low not because their trade relations are weak but because their economy size is small and their trade is underdeveloped.

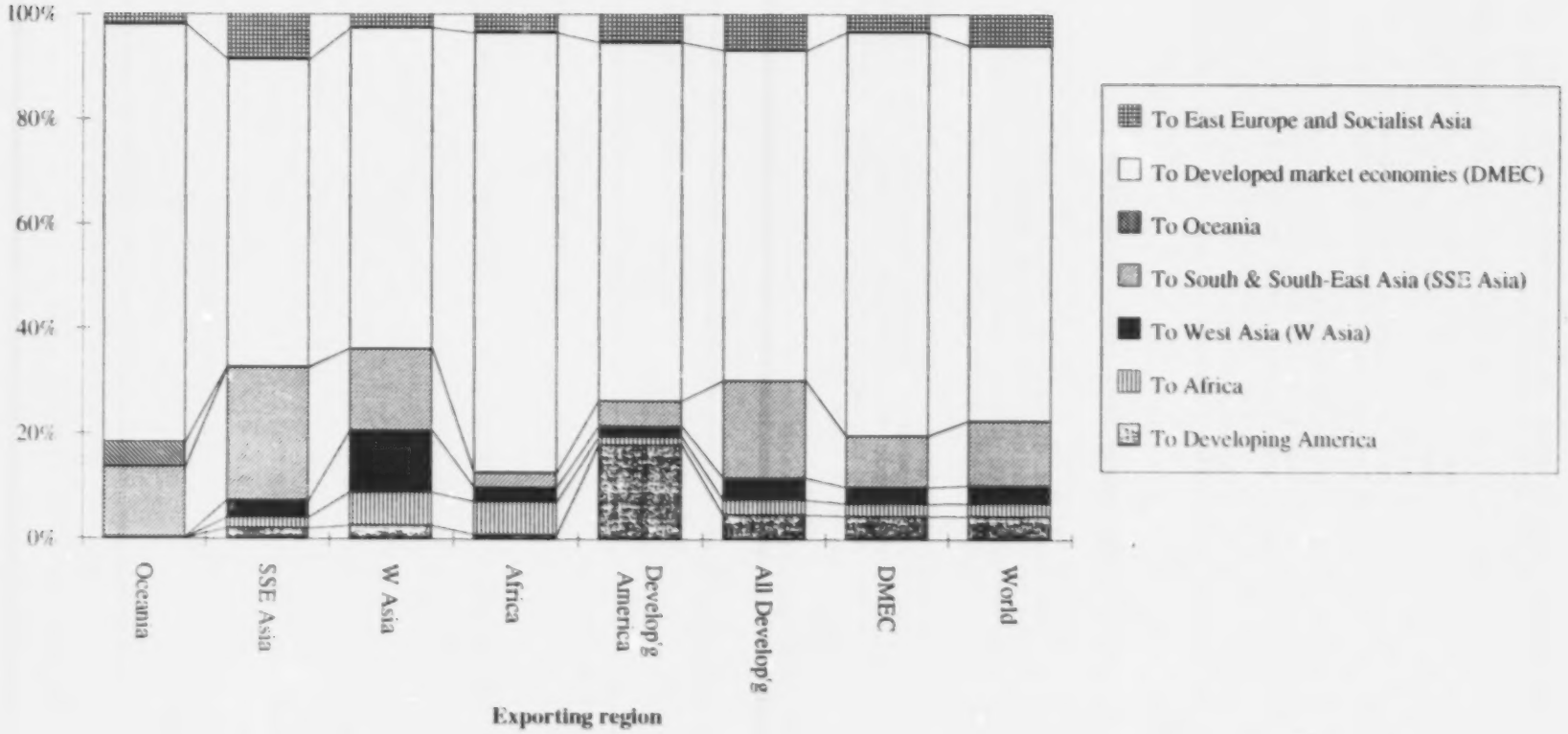
25. This may also be seen in Chart 2, in which the shares of export destination from each region are compared. The chart clearly shows that intra-regional trade occupies a larger share in each region than the region's

[9] This is the *log-ratio* of (i) the share of a trade flow in world trade to (ii) the hypothetical share of the same flow under the assumption that all countries were trading proportionally (i.e. the mathematical product of the import share of the origin and the export share of the destination in the world); in other words, it compares the percentage share of trade flows with the hypothetical share of imports weighted by the export share. The underlying model is analogous to the *generalized gravity model* in which: (i) the volume of trade flow corresponds to the gravity pull; (ii) the sizes of total imports and exports of the destination and origin correspond to the masses of the objects; and (iii) the trade intensity corresponds to the distance between the two objects (i.e., trade intensity measures the hypothetical "distance" between the origin and destination in terms of trade relationship). The model is "generalized" in that the distance factor is expressed in the power of exponential rather than the square of the distance.

Chart 2

Distribution of export destination for developing regions

(1991 figure)



share as the export destination in any other region (that is, for example, Oceania exports to Oceania more than any other region does in proportion).

26. This result indicates that: (a) countries in the same region are natural trading partners in most cases; (b) the success in promoting intra-regional trade is more likely to come through overall economic development of the region; and, (c) a comprehensive development strategy through regional cooperation - not only in trade but also in other areas such as infrastructure and investment - can be effective in increasing intra-trade.

27. In contrast, the coefficients show that inter-regional trade among developing countries is low both in its absolute level and in trade intensity, except for trade between South to South-East Asia and Oceania and exports from West Asia composed mostly of petroleum products. This implies that the potential of inter-developing region trade is yet to be exploited, and direct measures of promoting inter-regional trade (e.g. trade fairs) can be effective.

C. Intra-grouping trade among developing countries

28. Trade among developing countries in an integration grouping still appears to be low; for most groupings, intra-grouping trade represents well below 10 per cent of total exports of the member countries (Andean Group, ECOWAS, CARICOM, UDEAC, ECO, CEPGL, MARIUN) and, in some exceptional cases, from 10 to 20 per cent (ASEAN, CACM, LAIA).

29. Like intra-regional trade, these figures do not necessarily mean that these trade relations are weak. On the contrary, for every grouping, the share of intra-grouping trade well exceeds the share of the member countries as a trade destination in the world, implying that countries in the same grouping tend to trade with each other much more than the world average.

Table 5 Intra-grouping trade

(1990)

	Share of intra-grouping trade in total exports of the group	Share of the group in world imports	Share of the group in world exports
Developing America			
CACM	15.6	0.18	0.12
LAIA	10.9	2.3	3.3
CARICOM	5.6	0.23	0.19
Andean Group	4.2	0.49	0.91
Africa			
CEAO	10.8	0.17	0.15
ECOWAS	5.6	0.38	0.60
UDEAC	4.3	0.11	0.17
MARIUN	0.7	0.03	0.03
CEPGL	0.5	0.007	0.002
Asia			
ASEAN	18.5	4.5	4.2
ECO *	3.7	1.3	1.0

Source: *UNCTAD Handbook of International Trade and Development Statistics, 1992*

* Islamic Republic of Iran, Pakistan, Turkey

30. In 1990, the share of intra-grouping trade was highest with ASEAN, at 18.5 per cent, reflecting the rapid economic development and intertwined production structure in the area. An interesting feature of this grouping is that the deepening of economic integration took place only with a loose trade cooperation (preferential trade arrangement until recently) but through independent economic advancement of the countries in the region.

31. All the Latin American groupings have increased intra-trade significantly during the last five years, bringing up the level to a respectable one. In 1990, the share of intra-grouping trade in Latin America ranged from 4.2 per cent for the Andean Group to 15.6 per cent for CACM. This, together with the recovery in intra-regional trade and the renewed interest in regional integration in Latin America, may auger a bright future for economic integration in this region.

32. Intra-trade in most African groupings continues to stay at a low level. Intra-grouping trade, however, is not alone in this respect - it is rather the result of the stagnation in overall development of the African continent.

D. Conclusion

33. Trade among developing countries, though showing some recovery since 1986, is still low in its absolute level. Except for inter-regional trade, this is not because the trade relationship is weak but because overall imports and exports are small - whether with developed or developing countries. Thus, it would seem that a comprehensive approach to regional/sub-regional development may be the answer to weak trade links. Intra-regional trade can be developed only if the overall economic development of each country in the region can be effected through deepening of cooperation and comprehensive approaches to regional industrial development.

34. In sum, this investigation suggests that regional/sub-regional integration can be successful if it is deepened in such a way that integration bears on economic development. Conversely, less cooperation will be successful when development reaches a certain threshold.

35. The next section considers how economic development can be promoted, in particular through trade, and examines what constitutes the conditions to propel so-called "export-led growth".

III. DEVELOPMENT THROUGH TRADE

A. Export-led growth in a theoretical and historical perspective

36. There is a wide measure of agreement that economic development is most likely to be achieved through outward-oriented policy and trade liberalization. Trade liberalization is considered to raise efficiency through increased competition both in domestic and foreign markets. If export is successfully promoted, the consequent capital accumulation and investment will strengthen domestic production capability - both in technology and capacity - and lead to further expansion of trade and growth. The question is under what circumstances this *virtuous* circle, or "export-led growth", can take off.

37. The theory of export-led growth is easy to understand: Export growth not only directly raises income of production factors in the exporting sector but also creates new demands for the inputs and services. Expansion of the export sector can, by putting pressure on domestic production capacity, stimulate technological change. It may also, through the reduction of cost *via* scale

economies, stimulate new production which uses its product as an input.[10] Moreover, a dynamic export sector open to the rest of the world creates an international business culture which has a modernizing effect on the economy.

38. Historical examples for export-led growth abound; the prime example might be the rise of Great Britain as a world power through exports of, first, textiles and, then, iron and coal. Modern-day examples include the rise of the so-called NICs in East Asia, such as Singapore, Republic of Korea, Hong Kong and Taiwan Province of China.

39. History however also reveals that export expansion has not always resulted in economic growth. While there are many examples of export-led development in primary commodities, there also exist exceptions. For example, the "South" region of the United States of America has been a major exporter of cotton of the world since the 1830s but did not subsequently become the centre of the country's development.[11]

40. Whether export growth leads to economic development depends, among other factors, on the characteristics of the export sector, external market conditions, and historical coincidence (such as war-driven demand). The literature on economic history seems to indicate that, in earlier stages of development, export expansion is more likely to turn into overall economic development when the export sector is labour-intensive (thereby facilitating labour concentration and further expanding demand) or capital-intensive (by stimulating technological development and production of capital inputs) but not land-intensive (which often diffuses, rather than concentrates, economic activities).

41. In the early development of Canada, for example, timber and wheat necessitated the development of a transport network, which subsequently facilitated westward immigration of the population and expansion of general economic activities, while fostering the establishment of farm-machinery industry as well. Furs, on the other hand, were a poor commodity for growth because they required vast amount of land while using very little cargo space.[12]

42. A similar contrast can be drawn between the milk industry, which is more *growth-inducing* (e.g., instrumental to the early development of Denmark, Switzerland and New Zealand), and the meat industry, which is less *growth-inducing* (e.g., Argentina or Mid-West USA). The former is a labour-intensive industry that requires fixed mature settlements of peasant population and provides the basis for later development of a manufacturing sector, while the latter is a land-intensive industry based on ranching or a nomadic lifestyle and leads to a dispersion of economic activities.

43. The economic, social and technological implications of promoting a particular industry must thus be taken into consideration in designing policies aiming at export-led growth. The questions to be addressed include: whether the increased production of the sector stimulates economic activities in general and technological development in particular; whether it has a spill-over effect onto other industries; and, whether it creates a modern society more suitable for later development.

44. Such conditions for export-led growth vary between countries and over time, depending on the export commodity as well as various geographical,

---

[10] Much of the theoretical discussion and historical examples in this section draws on C. P. Kindleberger (1962), *Foreign Trade and the National Economy*, (Yale University Press, New Haven).

[11] D. C. North (1956), "Agriculture in Regional Economic Growth," *Journal of Farm Economics 12*.

[12] The Canadian example is from various work of H. Innis. See Kindleberger *ibid.*

historical, social and economic factors. Hence analysis must be done on a case-by-case basis. With respect to commodities, for example, coffee is a high-value commodity for its weight and therefore requires relatively small transport costs, a factor which, in turn, does not promote the development of transport. Sugar cane is a bulky product and sugar production suits the Caribbean countries, for example, where sea transportation and excellent harbours are accessible at short distances. In fact, the development of harbours has been facilitated by the sugar trade. Both coffee and sugar have a long "dead season", but require great inputs of labour during the harvest season, creating a society with migrant seasonal workers. Some tree crops need relatively extensive disease control, such as rubber trees, which can stimulate technological development.

45. In a largely agrarian society, the food-processing industry for locally produced goods or labour-intensive light manufacturing may contribute more to social development than, say, a high-technology, capital-intensive industry where the technology is often not transferred to local labour force.

B. Cross-country comparison regarding export and development

46. In order to see whether export expansion connects to economic growth in the context of current developing countries, a cross-country comparison of the growth rates of GDP and exports during the 1980s is made in annex III (table C) and the results are summarized in table 6 below. Although there is only a modest correlation between GDP and export growth rates for developing countries as a whole (about 40 per cent), the correlation becomes much stronger if the major petroleum-exporting countries are excluded (about 70 per cent).

47. The correlation is more stable for countries with a higher export-growth rate. Both GDP and export growth rates were high[13] in: Republic of Korea, Taiwan Province of China, Thailand, Hong Kong, Singapore, Mauritius, Pakistan, Turkey, Malaysia and Morocco. All relatively developed and have a diversified export structure. In these countries, export growth indeed has led to growth

Table 6 Growth of GDP and exports of selected countries during the 1980s

	Average (percentage)			Correlation	
	GDP growth	Export growth	Three Products *)	GDP and export growth	Diversification and export growth
All countries	2.96	1.81	61.05	0.39	0.49
Non-major petroleum exporters	2.69	3.15	55.71	0.69	0.37
South to East Asia and Pacific	4.84	7.86	40.65	0.81	0.61
West Asia and North Africa	4.74	-1.70	64.88	0.004	0.83
Sub-Saharan Africa	2.38	1.31	75.63	0.59	0.18
Developing America	1.11	0.45	54.73	0.58	0.06

*) Three products = Share of three leading products in exports, a negative measure of diversification

[13] With the exception of Paraguay, where high export growth was not accompanied by high growth in domestic production.

in domestic production.

48. Both rates were relatively high, though to a lesser degree, in Bangladesh, Chile and Colombia, which have a modest degree of export diversification. Some countries, such as Chad, Burkina Faso, Mali and Nepal also had high rates on both counts in spite of a very low degree of diversification, most likely owing to the low absolute level of GDP and trade.

49. Stagnation in domestic production was observed in many counties with a low export growth, though the correlation was somewhat more unstable owing to the lower degree of export diversification that made the relationship more susceptible to the variation in external markets. Countries in this group include Central Africa, Liberia, Niger, Rwanda, Sierra Leone, Zaire, Zambia, Sudan, Samoa, Bolivia, Argentina, El Salvador, Guatemala, Guyana, Haiti, Nicaragua, Panama, and Peru.

50. Some of the low export-growth countries, however, had a modest to relatively high GDP growth, such as Jordan, Syria, Burundi, Ghana, Senegal and Egypt. Countries in this group, except Burundi, had a modest degree of export diversification.

51. Most of the major petroleum-exporting countries (Algeria, Kuwait, Bahrain, Saudi Arabia, Venezuela, *et al*) had a low or even negative export growth owing to the deterioration in oil price during the 1980s. For this group, the relationship between the export sector and domestic production was very weak.

52. Region-wise, the correlation is strongest in South to East Asia (about 80 per cent) where the export growth was highest among the developing regions, lower but still significant in Sub-Saharan Africa and Latin America (about 60 per cent), and almost non-existent in West Asia and North Africa where many countries rely heavily on petroleum exports.

C. Export growth and diversification

53. The analysis in the previous subsection indicates that there may be a correlation between export growth and product diversification of exports. This thesis is examined using a cross-country comparison of export growth with degree of diversification as measured by the share of three leading products (SITC 3-digit level)[14] in exports (see table 6 and table C of annex III).

54. Overall, it was found that high export growth is most likely to be achieved through diversification in the export structure. Countries with high dependency on a few products can have high export growth but they are exceptional; they are also susceptible to variation in few markets (the variance in growth rate is larger with the less diversified countries).

55. The relationship is significant for West Asia, North Africa and South to South-East Asia. It is not significant in Sub-Saharan Africa, however, owing to the low degree of diversity in most of the countries.

56. In Latin America, no relationship could be observed. If some exceptional cases were excluded, however, a modest correlation could be found.[15]

---

[14] The higher the share of three leading commodities in exports, the lower the degree of diversification. Most other indicators of diversification were found to have strong correlation to this one.

[15] The exceptional cases include: Nicaragua and El Salvador, which had negative export growth owing to political turmoil during the 1980s; Barbados, which relies more on tourism than exports; and, Paraguay, Chile and Colombia, which had a high growth in exports despite their dependency on relatively few commodities.

D. Conclusion

57. Export-led growth is a viable, if not necessarily the most effective, development strategy. To achieve economic development through trade, however, there must be an appropriate mix of exportable products - not only those with cash-earning potential but also those which have the potential of spreading growth to other industries and services, facilitating technological and human-resources development, and cultivating a society amenable to a modern industrialized economy. Such a product structure will naturally differ between countries as their social, geographical and economic condition varies. History shows that the appropriate product structure also changes over time, from labour-intensive agriculture to labour-intensive manufacturing, and to capital-intensive high-value-added manufacturing, or from a labour-intensive small-scale manufacturing to mass production, and to capital-intensive flexible production with high-skilled labour.

58. Diversification of the export structure is another important factor in achieving export-led growth. Almost all the successful cases of development involved those countries with a relatively diversified industrial base. Countries which rely heavily on a few commodities can occasionally experience exceptional growth, but it is subject to market volatility and, given the long-term trend of commodity price deterioration, may not be sustainable over the long run.

IV. SOME MAJOR ISSUES ON TRADE AMONG DEVELOPING COUNTRIES AND POLICY IMPLICATIONS

A. Product structure and the lack of diversity

59. As discussed above, the product structure and diversification of exports constitute major considerations in designing development policies. Tables 7 through 10 present the export structure of selected economic groupings. It is evident from the tables that export structures of many economic groupings among developing countries are not sufficiently diversified, though the degree varies among groupings.

60. Among the samples, several groupings rely heavily on a few commodities for their exports. These include: UDEAC (coffee, wood, crude petroleum, precious stones), CEPGL (coffee, tea, copper), GCC (petroleum and related products), and CACM (coffee, fruits and nuts). Some other groupings, albeit less so, rely on certain product groups which account for a large portion of exports; for example, SAARC (textile and related products, tea and mates) and Andean Group (mining).

61. The tables reveal the lack of diversification which is evidently a major hinderance for increasing intra-developing-country trade. This is particularly so for countries which rely heavily on *cash-earning* commodities - as many less diversified countries do - because much of the demand for such commodities exists in developed countries.

62. The tables also show that the major export items of less diversified countries, while cash-earning, may not often be *growth-inducing*; for example, the mining industry (gold, precious stones, etc.) can be a major source of hard currency but it may neither encourage local capital accumulation as capital goods are often imported from abroad, nor stimulate technological progress with relatively little processing being required.

63. Conventional thinking often viewed diversification in the context of import substitution policy, and assumed that countries relying on imports for non-traditional goods should foster domestic industries to reduce their foreign dependency and outflow of foreign reserves. Policies guided by such a principle tended to invite "diversification for diversification's sake", and

result in resource transfers from the traditional sector to an infant modern sector, still inefficient and, in many instances, state monopolies. In the current context, more attention is accorded to policies which foster those industries likely to assist the development process or, in other words, the industries which either bring in new technologies or create linkages backward and forward to the rest of the economy. Among such industries are included, processing of locally produced agricultural commodities and light manufacturing not requiring high-technology.

64. While the above arguments apply to major export sectors, intra-regional trade in the traditional sectors - typically food and necessities - can be stimulated through regional trade liberalization since neighbouring countries are natural trading partners. Although this trade may certainly improve welfare and stimulate the economy, it may still be small in revenue terms and it alone cannot be the major impetus for which to boost export-led development.

65. Finally, and perhaps most importantly, many of the less diversified economies specialize in like products; namely, coffee, cocoa, fruit (bananas in particular), sugar, fish, precious stones, gold, crude petroleum, etc. Such a concentration in a few products can easily lead to an oversupply

Table 7 Major export products of selected countries and groupings: (1) West Asia and North Africa

(1989-90)

	Agriculture, etc.	Minerals, etc.	Manufacturing
GCC			
Bahrain		Refined petro. (76)	Aluminium (6)
Kuwait		Crude petro. (40), Ref. petro. (31)	
Oman		Crude petro. (89)	
Qatar		Crude petro. (71), Ref. petro. (6), Gas (5)	Polymeric products, etc. (6), Iron, steel (4)
Saudi Arabia		Crude petro. (73), Ref. petro. (11)	
U.A.E.		Crude petro. (78), Gas (5), Ref. petro. (5)	
AMU			
Algeria		Crude petro. (48), Gas (27), Ref. petro. (21)	
Morocco	Crude fertilizer (12), Shell fish (5), Fruits, nuts (4)	Oxides, etc. (7)	Manuf'd fertilizer (10), Mens outwear (6)
Tunisia		Crude petro. (16), Oxide, etc. (5)	Mens outwear (14), Manuf'd fertilizer (9), Women's outwear (7)

Source: *UNCTAD Handbook of Trade and Development Statistics, 1992*

- The figures in brackets show the percentage share of the product item in the total exports of the country.
- The product category is according to SITC 3-digit level. The category names are abbreviated and therefore only indicative.

situation with attendant price deterioration of these commodities. Although various efforts have been made to establish international agreements to control the supply and price of commodities, such attempts have not always been successful. For example, the price of coffee steadily deteriorated from 1986 to 1992 (see table 11), reflecting the difficulties faced in international negotiations. According to the *UNCTAD Trade and Development Report 1993*:

> The International Coffee Agreement, 1983, with its economic provisions suspended since July 1989, ... In April 1992, the

Table 8 Major export products of selected countries and groupings: (2) Sub-Saharan Africa

	Agriculture, etc.	Minerals, etc	Manuf
UDEAC			
Cameroon	Coffee (12), Cocoa (11), Wood (6)	Crude petro.(17), Aluminium (8)	
Central African Rep.	Coffee (20), Wood (9), Cotton (6)	Precious stones (50)	
Chad	Cotton (42), Animals (food) (19), Vegetable materials (7)		
Congo	Wood (7)	Crude petro. (80)	
Gabon	Wood (6)	Crude petro. (77), Metal ores (7)	
CEAO			
Burkina Faso	Cotton (38), Animals (food) (9), Vegetable (6)	Gold, etc. (35)	
Côte d'Ivoire	Cocoa (35), Coffee (14), Wood (9), Fruits, nuts (8)		
Mali	Cotton (47), Animals (food) (29)		
Mauritania	Shell fish (36), Fish (9)	Iron ore (48)	
Niger	Animals (food) (14)	Radioactive material (79)	
Senegal	Vegetable oils (15), Processed fish (12), Fish (9)	Ref. petro. (12), Oxides, etc. (8)	
MARIUN			
Guinea		Metal ores (84), Prec. stones (9)	
Liberia	Natural rubber (26), Wood (29)	Iron ore (28)	
Sierra Leone	Shell fish (10)	Prec. stones (22), Metal ores (21)	
CEPGL			
Burundi	Coffee (76), Tea (9)		
Rwanda	Coffee (67), Tea (19)		
Zaire	Coffee (11)	Copper (59), Crude Petro. (14), Prec. stones (7)	

See Table 7.

International Coffee Council established a Negotiating Group for the negotiation of a new, market-oriented International Coffee Agreement on the basis of universal quota ... The Negotiating Group has not been able to bridge the gap between different views ... The fluctuations of coffee prices in 1992 were very much influenced by this negotiating process. After the largely sterile meeting of the Council in July, prices fell to their lowest levels.

Table 9 Major export products of selected countries and groupings: (3) Latin America

	Agriculture, etc.	Minerals, etc.	Manuf.
CACM			
Costa Rica	Fruits, nuts (25), Coffee (18), Vegetable materials (4)		
El Salvador	Coffee (45)		Medical, pharm. products (4)
Guatemala	Coffee (29), Sugar (11), Fruits, nuts (7)		Medical, pharm. products (4)
Honduras	Fruits, nuts (35), Coffee (30), Shell fish (4)	Zinc (4)	
Nicaragua	Coffee (26), Meat (18), Cotton (10), Sugar (9)	Gold (5)	
Andean Group			
Bolivia	Wood (5)	Gas (25), Metal ores (24), Tin (10), Prec. metal ores (7), Silver (5)	
Colombia	Coffee (24), Fruits, nuts (5)	Crude petro. (21), Coal (8), Ref. petro. (6),	
Ecuador	Fruits, nuts (17), Shell fish (14), Coffee (6), Cocoa (5)	Crude petro. (45), Ref. petro. (5)	
Peru	Animal feeds (11)	Copper (19), Metal ores (16), Refined petro. (7), Zinc (5)	
Venezuela		Crude petro. (65), Refined petro. (13), Aluminium (6)	
MERCOSUR			
Argentina	Animal feeds (12), Vegetable oils (8), Wheat (7), Meat (5), Oil seeds (5)	Ref. Petro. (5)	Leather (4)
Brazil	Animal feeds (6), Coffee (5), Processed fruits (4)	Iron ore (7), Iron (5)	Footwear (4)
Paraguay	Oil seeds (33), Cotton (32), Meat (12)		
Uruguay	Wool (19), Meat (15), Leather (7), Rice (6)		Headgear (4)

See Table 7.

66. While the immediate concern may be in the stability and recovery of commodity prices through such policies as the establishment of a quota system or buffer stocks, the long-run solution may be the diversification of commodity concentration in supplier countries. Regional cooperation can be an effective venue in which to pursue either policy objective, since many regional groupings have high concentrations in the same commodities among their member countries. One means of utilizing a regional cooperation scheme is for coordination of positions during international negotiations; another can be cooperative diversification planning.

Table 10 Major export products of selected countries and groupings: (4) South and South-East Asia

	Agriculture, etc.	Minerals, etc.	Manufacturing
ASEAN			
Brunei		Crude petro. (46), Gas (41)	
Indonesia	Veneers, etc. (11), Natural Rubber (4)	Crude petro. (24), Gas (13), Ref. petro. (4)	
Malaysia	Vegetable oil (6), Wood (6), Shaped wood (5), Natural rubber (5)	Crude petro. (13)	Transistors, valves, etc. (15), Radio (4)
Philli-pines	Vegetable oil (5), Fruits, nuts (5)		Transistors, valves, etc. (10)
Singapore		Ref. petro. (16)	Computer equip. (12), Transistors, valves, etc. (7), Telecom equip. (4)
Thailand	Rice (7), Shell fish (5), Natural rubber (5), Processed fish (4), Vegetable (4)		Office equip. (4)
SAARC			
Bangla-desh	Shell fish (11), Jute (7)		Mens outwear (22), Leather (9), Woven fabric (8), Women's outwear (7), Textile articles (6)
India	Tea & mate (3)	Prec. stones (18), Iron ore (3)	Women's outwear (6)
Nepal			Carpets (45), Under garments (30), Leather (5)
Pakistan	Cotton (12), Rice (5)		Yarn (17), Cotton fabrics (11), Textile articles (9), Leather (5), Carpets (5)
Sri Lanka	Tea & mate (25), Natural rubber (5)	Prec. stones (9)	Women's outwear (13), Mens outwear (7), Outwear knit (5)

See Table 7.

Table 11 Coffee: Price and export quantity in the world

Year	Price *	Export quantity (thousand tons)		
		Developing countries		World Total
1986	3768	3786	(92.36%)	4099
1987	2377	4156	(92.95%)	4471
1988	2557	3829	(90.99%)	4208
1989	2021	4365	(91.22%)	4785
1990	1577	4601	(91.02%)	5055
1991	1473	4511	(90.42%)	4989

Source: *UNCTAD Commodity Yearbook, 1993*

* Composite price index (I.C.A.), US dollar per metric ton.

B. Some theoretical issues of trade integration: Trade creation and diversion versus dynamic effects

67. In the literature on economic integration, the issue of trade creation and diversion recurs frequently.[16] These concepts however are sometimes either over-emphasized or mentioned in a misleading context. Hence clarification may be appropriate here to set them in perspective in terms of trade integration among developing countries.

68. Trade creation or diversion can occur when trade integration is formed among several countries and a portion of trade is redirected. Trade creation occurs when intra-grouping trade expands, shifting some production within the grouping from importing to exporting countries. Since the exporting countries produce the goods more efficiently, this contributes to the improvement in the total welfare. Trade diversion occurs when some imports from outside the integration grouping are replaced with intra-grouping trade but the outside producers were more efficient than the inside ones, hence causing a decrease in the total welfare. Thus the discussion of trade creation and diversion concerns essentially total welfare (including the welfare of third countries outside the grouping), or in the original words of Viner (1950), whether the results of trade integration are in conformity with the views of free-traders or protectionists.

69. First, the term "trade diversion" is often misused owing to its confusion with cases where trade is "diverted" in a generic sense. For example, consider a small country with a preferential access to a neighbouring country's market. Suppose the two countries form a customs union together with a third country which can produce the same products more efficiently. As a result, the small country loses its edge of having preferential access to the neighbouring country's market, while the more efficient third country takes over the market. In this case, although the small country makes a loss because the trade is "diverted" in a generic sense, this is not a Vinerian

[16] The literature on trade creation and diversion was pioneered by J. Viner (1950), *The Customs Union Issue*, (Carnegie Endowment for International Peace, New York, and Stevens & Sons, London); hence these effects are sometimes referred to as the *Vinerian* effects. It is followed among others by: J. E. Meade (1955), *The Theory of Customs Unions*, (North-Holland, Amsterdam); R. G. Lipsey (1960), "The theory of customs unions: a general survey," *Economic Journal 70*, pp. 496-513; H. G. Johnson (1962), "The economic theory of customs union," *Pakistan Economic Journal 10*, pp. 13-32; R. G. Lipsey (1970), *The Theory of Customs Unions: A General Equilibrium Analysis*, (Weidenfeld & Nicolson, London); and P. Robson (1980), *The Economics of International Integration*, (George Allen & Unwin, London).

trade diversion effect since the production is shifted from inefficient to efficient producers. This is an example of the problems caused by the lack of "transfer" assumed for the Pareto optimality or, in other words, the small country should be "compensated" for the trade integration to be beneficial to all participating members.

70. Secondly, it should be noted that the original definition of Viner (1950) did not include effects on consumers through price changes; therefore the conclusion differed from the one widely agreed on now (the negative effect of integration was over-estimated). Consumer effects were later incorporated by Johnson (1962), whose definition was endorsed by Viner himself.[17]

71. Thirdly, in policy discussions on trade creation or diversion effects, utmost attention should be paid to the incidence of the effects. The effects of trade creation or diversion benefit producers in the exporting countries inside the grouping at the cost of producers both in the inside importing countries and outside exporting countries. The consumers within the grouping see their importing prices drop but exporting prices rise. The tariff revenues of the governments of the grouping may increase or decrease. Overall, a country inside the grouping definitely gains as an exporter of a good and, as an importer of a good, it may gain or lose. As an importer, the country gains: (a) if the pre-integration tariffs were high; (b) if the tariff reductions are significant; (c) if the elasticities of demand and supply are sufficiently high; or (d) if the production cost differential between the outside exporters (more efficient) and the inside exporters (less efficient) is sufficiently small.[18] The only absolute losers are the countries outside the grouping that export to the integrated market.

72. The above analysis indicates that, since every country in an integration grouping exports some goods and imports others, participating countries are likely to have net gains from such trade integration.[19] This implies that, in most cases, the trade creation and diversion effects become a problem only with respect to third countries.

73. If so, trade diversion becomes a problem virtually only when the integrated market is large, such as the case with NAFTA (which potentially redirects the United States of America's imports from Asian NICs to Mexico). For trade integration among developing countries, these effects *per se* should not be a cause for great concern as the impact is felt only marginally, and the integrated developing countries themselves gain.

74. For trade integration among developing countries, it is also true that the risk of one or more of the integrated countries having a net loss from trade diversion is not entirely negligible, because (a) the redirection of trade is likely to shift the production to less efficient producers in developing countries; (b) the efficiency differential can be substantial; and (c) the elasticity of demand can be sufficiently low (owing to the similarity of the production structure among countries). If this is the case, the loss

---

[17] J. Viner (1965), "Letter to W. M. Corden dated 13/3/1965," *Journal of International Economics 6*, pp. 107-8.

[18] The net gain for the importing countries equals the reduction in the deadweight loss (positive) plus the tariff-revenue differential (positive or negative).

[19] This statement is true only as far as trade creation and diversion effects are concerned - there can be other effects that cause gains or losses in addition to these effects. Also, note that this conclusion departs from the original Viner argument because it incorporates consumer effects.

Table 12 Effects of trade integration: Static and dynamic effects

	positive effects	*negative effects*
static effects	trade creation	trade diversion
dynamic effects	rationalisation of industries, scale economies, enhanced competitiveness,	adjustment costs (e.g. temporary unemployment due to the restructuring of industries)

would manifest itself as a drop in tariff revenues.[20]

75. The magnitude of potential negative effects, however, should not be over-emphasized. Such effects will manifest themselves only if sufficient redirection of trade takes place and, as experience shows, this is usually a rather slow process. More often than not, the redirection of trade does not take place immediately following the drop in internal tariffs, but rather because of demand-led market expansion of regional producers, the improvement in their marketing skills, rationalisation and realignment of industries that result in the deepening of specialization among regional countries, etc., all of which take place over time. These are termed "dynamic" effects of trade integration.[21] In fact, the central issue for most developing-country integration is whether these dynamic effects are large enough to compensate the loss in tariff revenue and adjustment costs, and whether the trade integration eventually leads to economic development through these dynamic effects.

76. The dynamic effects have both positive and negative sides: On the positive side, trade integration in general intensifies competition and, hence, induces rationalization of industries and enhances domestic competitiveness. Also, trade integration facilitates the realignment of industries so as to further the specialization among countries in the grouping, thereby raising productivity through economies of scale. Other potential benefits of trade integration include greater opportunities to learn new technologies and the skills of trade and marketing. All these processes, however, produce side-effects in the form of adjustment costs. The rationalization and realignment of industries will create unemployment, at least temporarily, and the sunk costs spent on the inefficient industries will be lost without producing further returns.

77. Practically, these dynamic effects have much greater political weight for the governments evaluating the possible consequences of trade integration, compared to static issues such as trade creation or diversion. What concerns the governments most is, again, the extent to which trade integration raises the competitiveness of domestic industries and eventually leads to economic development, compared with the extent to which the trade integration induces

---

[20] These so-called "collateral losses" of fiscal revenue often becomes a big hurdle for integration among developing countries since, as compared to developed countries, many developing countries rely heavily on tariff revenues for government income.

[21] The dynamic effects are emphasized more in more recent literature. For example, see M. N. Jovanovic (1992), *International Economic Integration*, (Routledge, London). Note that the terms "static" and "dynamic" effects do *not* imply that the former take effect immediately and the latter over time, but rather that the former indicate the effects that appear when the two static (or stable) states before and after the policy are compared, while the latter concern those that appear during the change before the economy arrives at the new static (stable) state.

unemployment, dislocation of labour and potential social unrest, or loss of heavily-invested state enterprises.

C. Unbalanced benefits from integration, multi-track liberalization programmes and compensation schemes

78. One of the major sources of failure in economic integration has been the dissimilarity of member States within a grouping. Dissimilarity would cause imbalance in the costs and benefits from integration. Economically weaker or smaller countries may fear the domination of stronger or larger countries. The more developed countries may fear the loss of employment to the cheaper labour in the less developed partners.

79. From the viewpoint of promoting intra-regional trade, however, it has been pointed out that dissimilarity of countries may be an advantage. Groupings with diversity should be encouraged to proceed with mutual trade liberalization. For these groupings, therefore, some mechanism must be devised to mitigate any pain caused by the imbalance and to minimize the risk of collapse of the scheme; meanwhile, other modalities should be sought to encourage cooperation in trade-related fields, such as joint ventures to create regional products.

80. One way to mitigate the imbalance problem is to introduce a multi-track trade liberalization programme, in which a different timetable for trade liberalization is set for countries/sectors with different degrees of development. An example can be found in MERCOSUR, in which two relatively underdeveloped countries (i.e. Paraguay and Uruguay) have been allowed a longer adjustment period for tariff reduction than the others (i.e. Brazil and Argentina). Another example is the recently announced multi-track liberalisation programme towards formation of a free trade area among ASEAN countries (AFTA).

81. In adopting a multi-track scheme, one policy implication should be kept in mind: a multi-track scheme is generally designed to give economically weaker countries or sectors more time to adopt liberalization measures. These measures are intended to strengthen the competitive capacity of industry by raising the level of competition and enlarging the market. Therefore, if the economically stronger countries (or sectors) are taking liberalization measures earlier than the weaker ones, the stronger ones would have gained strength by the time the weaker ones get exposed to the competition. Thus the gap would have expanded in the absence of counter-measures. In order to avoid this pitfall, every effort must be made to enhance the weaker economies or sectors during the period of relative protection from liberalization.

82. Another way to address the imbalance is a compensation scheme, in which the relatively developed countries provide compensation to the relatively underdeveloped. A compensation scheme, however, is apt to face some difficulties in implementation. First, there may be a general lack of resources to finance the programme. Secondly, since compensation involves a financial transfer between countries (or sectors), it may create political problems. Thirdly, since the costs and benefits from integration cannot be exactly measured, the provider countries may feel that they are giving too much while the recipient countries consider may believe that they will receive too little.

83. An idea along similar lines would be to set aside a certain portion of international aid and establish a compensation fund or a development fund for the less-developed partners, specifically ear-marked for integration purposes.[22] The fund would be drawn on only when concessions were made for

---

[22] Foreign aid to "regional" projects, as compared to "national" projects, has been given, at best, marginal priority. For multilateral assistance, only 8 per cent of the UNDP fund, which covers most of the UN development assistance projects, was directed to regional projects (as of December 1991). Bilateral (continued...)

integration purposes and at the discretion of an intergovernmental body. Thereby estimated losses could be compensated and the level of the underdeveloped members raised.

84. Under such a scheme, each programme for integration would have to be justified over alternative development programmes. Given that the justification is sufficiently strong, the member governments may consider redirecting a portion of foreign aid to the integration programme from national programmes. This would indicate strong commitment of the member governments to the integration programme so that donor countries may find it easier to provide the fund in addition to the other aids, for example, in the form of matching grants from the integration fund.

D. Implementation problem: Political factors and institutional aspects

85. Another major problem facing regional trade cooperation has been the general lack of policy implementation. There are two major reasons for this. First, there are the political difficulties that any "reformist" government faces in an attempt to implement policies which fundamentally affect the structure of political interest. Secondly, there can be inadequacies in public bureaucracy charged with properly implementing policies. These factors should be considered when designing policy packages, although countries vary on the degree to which political and institutional problems cause difficulties in implementation.

86. A recent study by Levy (1993)[23] found that, in many developing countries which attempted to implement trade or investment reforms, the bottlenecks were often weakness in institutional capabilities rather than political difficulties. If so, "institution-light" policies, such as tariff reforms and elimination of quantitative restrictions (so-called "stroke of a pen" policies), should be given preference over "institution-heavy" policies, such as provision of incentive packages or duty exemptions on selective products or sectors.

87. If the bottleneck proved to be the political difficulties, the practical policy choice would be between: (a) not-so-drastic policies with a view to gradual reform, or (b) across-the-board policies with only minimal exceptions. A recent study by Alam and Rajapatirana (1993)[24] analysed trade-reform experiences in Latin America. Their findings support the latter approach, as: "trade reforms were more successful if they were bold and extensive" because "wide-ranging, vigorously implemented reforms send a powerful signal of the direction of government and liberate that policy from parochial and vested interest."

88. Levy (1993) studied the experiences of 12 countries[25] that underwent

---

[22](...continued)
assistance has a worse record; during 1985-90, on average, less than 1 per cent of the total assistance from OECD/DAC countries (18 major aid contributors) was directed towards regional programmes and projects. For more detail on this issue, see UNCTAD/ECDC/232, 10 February 1993, *Review of International Support for Regional Integration and Cooperation among Developing Countries*.

[23] B. Levy (1993), "An Institutional Analysis of the Design and Sequence of Trade and Investment Policy Reform," *The World Bank Economic Review 7, No.2*.

[24] A. Alam and S. Rajapatirana (1993), "Trade Policy Reform in Latin America and the Caribbean in the 1980s," PRWP 1104, the World Bank. The quotation was taken from its summary paper on *Finance & Development 3, No.3*, September 1993.

[25] Bangladesh, Ghana, Guinea, Jamaica, Kenya, Mauritius, Mexico, Morocco, Pakistan, Philippines, Thailand, Tunisia, with double entries from Kenya (before and after 1988) and Philippines (under Marcos and Aquino).

reforms in trade and/or investment policies. For the tariff reforms and the removals of quantitative restrictions (institution-light policies), problems in adoption of the policies (i.e. political problems) were faced by several countries including Kenya, Philippines, Tunisia and Thailand, while only Kenya and Guinea experienced any implementation difficulty. It was found that: "Guinea in particular has been subject to chronic organisational weaknesses" as attested by the fact that the Central Bank continued to allocate foreign exchange long after the import-licensing system had been abolished in 1987, or because individual ministries were negotiating *ad hoc* tariff exemptions with firms despite the adoption of a uniform tariff code in 1986.

89. On the other hand, for the provisions of duty/tax exemptions or drawbacks for exporters (institution-heavy policies), the results are much more mixed. For example:

- As of 1988, only 40 countries regularly took advantage of Kenya's duty drawback scheme though it has been in place for more than ten years;

- In the Philippians, drawback and exemption schemes became mired in excessive and discretionary bureaucratic procedures, affording firms only 12 million US dollars in customs and tax rebates in 1985, five years after the schemes had been implemented;

- Thailand's implementation of drawback and exemption schemes appears to have improved continually over time, with the ratio between duties returned to firms through drawback or exemption and actual duty collection rising from 25 per cent in 1983 to 60 per cent in 1987.

90. These experiences show that, in the design of liberalization policies, close attention should be given not only to the political situation of the country but also to the implementation capability of its public administration - whether too many exceptions and/or procedural requirements affect the policies for them to be effectively implemented within available capacities of public administration of the country.

91. External political factors have also impeded the development of intra-regional trade. The Arab region may be the most evident and salient example of such political problems obviating efforts to expand regional trade. A recent UNDP/UNCTAD/ITC Report on Arab trade expansion[26] notes that "the military and political conflicts involving many of the 21 Arab League members (during the 1970s and 80s)" not only directly hindered the flow of intra-regional trade but also caused "countries to undertake trade measures arresting completely specific flows of intra-Arab trade as a means of exerting economic and political pressure." The report continues that "opening and closing the trade 'tap' for political reasons inevitably was detrimental to building lasting relationships based on confidence and trust," and "most trade is conducted with a horizon as short term as possible (since) longer-term perspectives for trade development carried too many risks."

92. These problems have been exacerbated, the report points out, because:

> ... most, if not all, of the Arab regimes control and operate their countries major economic and commercial resources and institutions. There is as yet no vibrant private sector to exert the necessary political and economic pressures to safeguard and foster intra-regional trade and business relationships. The public sector having a dominant role in large scale productive activities and in the purchase and sale of goods could be directed to interrupt or expand regional trade, suspend or activate trade credits and capital transfers, or hinder or facilitate trading links according to the ever shifting political alignments in the region.

---

[26] UNDP/UNCTAD/ITC (1992), "Report on A Programme for Technical Cooperation for Trade Development in the Arab Region," Geneva.

93. This observation suggests that fostering of a private sector capable of producing marketable products and conducting trade by itself not only contributes directly to trade expansion, regional or inter-regional, but also could be an effective means of redressing instability arising from political factors in trade relationships.

V. PROSPECTS FOR SUCCESSFUL TRADE COOPERATION AND INTEGRATION

94. This section examines actual regional cooperation schemes in the light of the discussions in the previous section. It also touches on how the policy orientation should look, in view of the difference between the various groupings' economic characteristics.

A. Integration of small and homogeneous countries

95. Formation of a regional grouping by relatively small and homogeneous countries is the classic case for economic integration. Economic groupings that fall into this category may include CACM, CARICOM, CEAO, MARIUN and, albeit a little less homogeneous, CEPGL and UDEAC.

96. Because of their smallness, countries can benefit fully from integration through economies of scale; efficiency gains can be achieved through enlargement of the market, rationalization of production, increased competition, conservation and more efficient use of scarce resources, particularly of human resources with technical expertise. Being homogeneous, these groupings are relatively free of the problems associated with imbalances described in the previous section.

97. The lack of diversity and the heavy reliance on cash-earning commodities,[27] on the other hand, is likely to lead to stagnation of intra-grouping trade, as pointed out above. Although dismantling of trade barriers among member countries should not be discouraged by any means, the promotion of intra-grouping trade cannot be considered as the *primary* policy objective of integration. Instead, the potential policy objectives of integration for homogeneous groupings are likely to be: (a) utilization of economies of scale; and (b) utilization in trade relationships of the integration grouping as a coherent economic unit *vis-à-vis* the outside world.

98. The desirable form of economic integration for this type of economic grouping may be a customs union, a common market or an economic union.[28] These "stronger" forms of integration allow economies of scale to be used to the fullest. Not only does it facilitate trade and provide efficiency gains, but it also provides the grouping with a "single market" aura that may have positive effects *vis-à-vis* the outside world, for example, in attracting foreign direct investment.

99. Given that many homogeneous groupings are composed of, relatively speaking, less developed countries, economic development of each country must be a foremost concern. To this end, the policy emphasis should rest on fostering growth-inducing industries and diversification of the production structure. Because of the latter's relative homogeneity in such countries, cooperation on this aspect can bring substantial benefits. Effective policy measures in this regard include: (a) concerted efforts towards diversification of the regional production structure; (b) joint infrastructure development; (c) joint human resources development; (d) harmonization of regulations and reduction of intra-regional barriers to foreign investment; and (e) cooperation in international negotiations on commodities on which the region

---

[27] See tables 7 through 10.

[28] Various forms of economic integration are explained in annex I.

relies heavily.

B. Cooperation of small countries with a dominant economy

100. Economic integration can be also offer members economies of scale benefits when small countries cooperate with a larger neighbouring country. Typical examples can be found in Europe: Luxembourg has been enjoying a customs union with Belgium; Liechtenstein has a similar arrangement with Switzerland. In the developing world, the relationship of Nepal and Bhutan with India may be a typical example of this type of cooperation. A comparative study of the latter with European cases could prove rewarding.

101. This model of cooperation could be potentially beneficial to the countries in the South African Customs Union,[29] where cooperation with the Republic of South Africa is expected to spread development throughout the region. Countries such as Botswana have already attained relatively high GDP by Sub-Saharan standards, partially owing to its proximity to South Africa. The future of this region, however, remains uncertain as it depends, among other factors, on the political and socio-economic outlook for post-apartheid South Africa.

102. In such cases, a customs union seems to be the natural policy choice as it optimizes material and human resources so much needed in smaller countries. Some counter-measures must be taken, however, so that smaller countries do not become dominated by the larger and/or stronger countries. It may be necessary, at least temporarily, to protect and promote indigenous enterprises in the smaller countries. A longer-term solution would be for the small countries to promote country-specific industries that take advantage of: (a) natural and human resources peculiar to the country (e.g. tourism, crafts) or (b) the legal and institutional flexibility inherent in smallness (e.g. offshore financial markets, free ports).

C. Integration among diversified countries

103. Groupings composed of diverse economies generally have the best prospects for increasing intra-trade. Development may be facilitated by fully exploiting economic complementarity, not only through the expansion of intra-regional trade but also through inter-linkage of production and investment in the form of vertical integration, cross investment, etc.

104. By the same token, disadvantage of such groupings is the imbalance that inevitably accompanies diversity; it can create difficulties in forming policy consensus both within each country concerned and among countries. Hence the improvisation of some mechanism to mitigate the effect of imbalances, such as multi-track liberalization, compensation schemes, development funds for underdeveloped countries may be useful. The merits and demerits of such mechanisms have been discussed in the previous section.

105. Another issue stemming from the question of diversity and imbalance is the sequencing and packaging of various policies. This feature becomes a problem because each individual policy can have a different impact on different countries. For example, liberalization of labour mobility can create problems in a high-wage country grouped with a labour-abundant low-wage country. Conversely, a labour-abundant country might worry that relaxation of restrictions on capital flows would invite domination by capital-rich countries. The sequencing and packaging of policies can only be decided on a case-by-case basis. Among other factors, it depends on the economic and political situation of the countries concerned as well as the negotiation process.

106. Given these considerations, integration may be more successful if it proceeds gradually. The probability of success may be greater when the

---

[29] Some countries are not small in terms of population or area.

initial objective is limited to the establishment of a free trade area, accompanied by policies that facilitate investment within the region, rather than immediately aiming at a stronger form of integration such as a common market. The latter can be envisaged once the initial phase has been proved successful.

107. One of the most economically successful examples of this type of grouping may be ASEAN, where member countries had been strongly pursuing economic development through liberalization of investment and trade with the outside world during the past decade. One of the key ingredients of its success seems to be the balance that it struck among trade, industrial and macroeconomic policies. Intra-grouping trade was facilitated not only through direct trade-liberalization measures but also through policies that would expedite foreign investment. This resulted in an increase in cross-border economic activities and intra-regional trade; meanwhile the vertical integration of regional economies progressed and the size of economies in the region expanded on a grand scale.[10]

108. Another regional grouping with a similar potential for success may be MERCOSUR. For MERCOSUR, the success probably depends on whether recent liberalization efforts induce economic growth in each member country, and whether such growth leads to an interlinked industrial structure among the member countries in order to exploit fully their economic complementarity.

109. Countries in groupings such as AMU, the Andean Group, ECOWAS, PTA/SADC, and SAARC are also diverse in terms of size and degree of development. AMU and the Andean Group may have the potential to follow a development path similar to ASEAN. As seen in tables 7 through 10, however, these groupings need to diversify their export structure further and to foster industries that are more growth-inducing. SAARC has also the problem of combining big-small countries in the grouping, as discussed above. Except for small countries such as Bhutan and Nepal, which need to cooperate in many ways so as to complement resource deficiencies, their gradual approach (unlike most other groupings, they envisage at present only a preferential trade area) may be the right strategy choice.

110. As development of the Sub-Saharan African groupings lags, more emphasis should be put on policies similar to those described earlier as being suited to small and homogeneous groupings. Some groupings, such as ECOWAS, may consider redefining their role, as described in the next subsection.

D. Cooperation in a wider and looser framework

111. Intergovernmental groupings with a wide membership can serve as a framework for economic cooperation in such areas as policy consultation and coordination.

112. APEC, as one of the broadest of this kind, offers an interesting example. The major function of this grouping is to provide a broad strategy and policy consultation mechanism for dealing with various economic issues, particularly trade and international monetary questions. On each particular issue, the strategies and policies are discussed by experts in a "forum", which reports to member Governments. The member Governments meet regularly at the ministry level to discuss the issue. The framework can be also used to treat compatibility and relationships of sub-regional integration groupings within; in the case of APEC, for example, the relationship between ASEAN, NAFTA and other potential groupings can be discussed.

113. Region-wide intergovernmental organizations such as OAU, LAS and OAS (or LAIA with expanded membership) may consider providing a similar service to their member countries. Given the broad membership and diversity of the countries concerned, it may be impractical for these organizations to consider

---

[10] As one example, the Indonesian experience with unilateral trade liberalization is described in annex II.

region-wide economic integration at this stage. The member States may be better served if these organizations clearly defined their role as providers of communication on economic policies.

114. In case of OAU, the road map was clearly drawn by a treaty, signed in 1991 by Heads of State at the Government Summit at Abuja, Nigeria, with the purpose of eventually establishing the African Economic Community. It was agreed first to concentrate on strengthening sub-regional integration and then to establish, in turn, sub-regional customs unions, a single continental customs union and finally the African Common Market. The success of such a plan clearly hinges on the first phase: the strengthening of sub-regional integration. Unless ways to solidify sub-regional integration are found and implemented, the plan will remain just another blueprint.[31]

115. A clear distinction in roles and division of labour between these region-wide umbrella organizations and smaller sub-regional integration groupings is needed. In this context, organizations such as LAIA and ECOWAS may need further to clarify their role because, first, these groupings contain smaller sub-regional groupings and, secondly, the number and diversity of member States might be too large for giving practical consideration to economic integration in the near future. One possibility would be to function as an umbrella organization, as described above.

116. Another function applicable to larger organizations would be to serve as a venue for discussions on bilateral or minilateral cooperation in specific areas (e.g. infrastructure, human resources development, joint venture) for any combination of member countries. For this, it might be useful to set up some mechanism for holding regular meetings of member countries at the executive level so as to explore various possibilities.

E. Policy instruments

117. Some policy instruments that can be utilized in regional cooperation are listed below:

In the area of trade policies,

- harmonization of the tariff structure with a view to eventually establishing a common external tariff;
- reduction and elimination of tariffs within the grouping;
- harmonization of rules of origin;
- harmonization, tariffication and/or elimination of regulatory non-tariff barriers (import regulations, import licensing, pricing regulations, etc.);
- reduction or elimination of other non-tariff barriers (quantity restraint on imports, foreign exchange quota, subsidies, etc.);

In industrial policies,

- coordination of positions *vis-à-vis* the outside world in trade negotiations;
- coordination of industrial policies for achieving region-wide diversification and a properly balanced production structure;
- harmonization of regulations and/or elimination of restrictions on regional investments;
- harmonization of regulations concerning foreign investment;

Sectoral cooperation

- joint infrastructure development (transport, communication, etc.);
- joint human resources development;

---

[31] In 1980, the Final Act of Lagos, adopted by OAU Heads of State and Governments, provided a plan of action and schedule of implementation for establishing AEC. The plan, however, received little attention thereafter.

- joint industrial development;
- cooperation on export promotion;

In monetary and financial policies,

- coordination of monetary and foreign exchange policies, with a view to the eventual establishment of monetary union;
- establishment of a regional monetary authority to advice national monetary authorities and harmonize monetary and foreign exchange policies, before the eventual establishment of monetary union;
- establishment of regional convertibility of currencies;
- coordination and harmonization of financial systems (harmonization of regulations regarding financial markets, establishment of a regional capital market, etc.).

Annex I

REGIONAL ECONOMIC INTEGRATION/COOPERATION: POLICY INSTRUMENTS

1. Regional economic integration or cooperation can be categorized into several forms.

2. A less stringent form of cooperation schemes rests on a loose consultative basis, such as Asia Pacific Economic Cooperation (APEC); then there is a broad North-South cooperation framework, such as that between the African, Caribbean and Pacific Countries (ACP) and the European Union (EU). This type of scheme essentially functions as a framework for policy consultation, coordination or cooperation on economic, trade and development issues. The channels established by the scheme can also be utilized to facilitate, for example, foreign aid or technical assistance programmes. Legal constraints on the policies of individual countries, however, are generally minimal in such schemes.

3. A stronger form of integration or cooperation is the establishment of a *preferential trade area* (PrTA) or a *free trade area* (FTA). These forms of trade cooperation concentrate on a reduction or removal of trade barriers in goods and services, but generally exclude free movement of factors, most importantly, of labour.

4. While the objective of either scheme is to promote regional trade, FTA takes more a comprehensive approach to trade liberalization than PrTA. For FTA, because the ultimate goal is to tear down all trade barriers, particularly tariffs, the process of forming an agreement is time-consuming. However, once agreement has been reached, the implementation process is relatively straightforward. For PrTA, the concessions are made basically on a sectoral or product-by-product basis and, since the governments can protect certain special interests, the process to reach each agreement is shorter. However, this also implies that some important items may easily be excluded from an agreement.

5. For FTA, countries are usually not obliged to harmonize their economic policies beyond trade relations among themselves. In reality, however, the establishment of FTA often motivates member countries to harmonize policies. For example, they may seek to establish a common technical or environmental standard of goods. Moreover, they often agree (and sometimes formally include this in their agreement) to pursue reciprocal liberal policies in related areas, such as relaxation of investment regulations. Also, they may cooperate on other means of trade promotion, for example, in establishing a reserve fund, a clearing house or a trade financing facility for the use of member countries.

6. If the agreement, in addition to the establishment of FTA, includes the establishment of a *common external tariff* (CET), it is called a *customs union*. In *theory*, FTA makes more sense when combined with CET because, otherwise, a third-country trade may bypass the higher tariff country and in effect nullify the tariff differences. In *reality*, however, there may be certain economic pre-conditions that make countries opt for establishing CET. Examples show that a customs union is likely to be chosen either: (a) when the participating countries are relatively small and there is no significant difference in terms of their economic relationship *vis-à-vis* the outside world - such is the case with CACM, but not with NAFTA, where Mexico and the United States have substantially different economic interests regarding the outside world; or (b) when there is one economically dominant country with substantially smaller neighbouring economies taking advantage of scale economies by joining in a customs union with it, such as the South African Customs Union.

7. Much stronger forms of economic integration include a *common market* and an *economic union*. While both forms of integration allow free movements of goods, services and factors (including labour), the latter implies the institutionalization of harmonization of economic policies in many respects.

8. There are also some bilateral arrangements which have a distinctively regional character; for example, Mexico and Chile signed an Agreement on Economic Cooperation in 1991. Its objectives are to increase bilateral trade and promote investments between themselves.

Annex II

A CASE STUDY: REFORMS IN INDONESIA

1. As an example of unilateral reforms, the case of Indonesia is interesting; during the 1980s, the country faced constant deterioration of prices for its main export commodity (i.e. petroleum) - an experience shared by many developing countries. It proceeded to restructure its economy through aggressive liberalization policies.

2. Throughout the 1970s, Indonesia's economy relied heavily on revenue from oil exports (at the beginning of 1980s, oil and gas accounted for as much as 25 per cent of GDP, 80 per cent of export earnings, and 75 per cent of government revenue); its policy stance was that of import substitution.

3. Oil prices peaked in 1981 then continued to decline throughout 1980s. In the face of this situation - worsening of the current account deficit and a sudden slow-down of GDP growth, the Indonesian Government initiated adjustment policies in 1982 to strengthen non-oil exports through devaluation of the currency, tax reform and cuts in public spending. During the succeeding years, however, an extremely high rate of inflation followed the currency devaluation. The Government then tightened its monetary policy and, finally, in 1985 inflation subsided.

4. The decline in oil prices persisted, however. The Government initiated more comprehensive reforms in 1986, termed the "May package"; this included a further currency devaluation, promotion of FDI, and relaxation of import restriction for exporting firms. The result was a high economic growth, particularly in the manufacturing sector, although the current account deficit has increased initially, owing to the more liberal import regime.

5. Encouraged by this development, the Government pursued its reforms through the remainder of 1980s; they included: further relaxation of the import regime, such as reduction in tariff rates, tariffication of various quantitative restrictions and expansion of duty exemptions; various measures further to encourage FDI; and, liberalization of the financial sector and reform measures to strengthen capital markets.

6. These policies resulted in a surge in exports as well as in investments both domestic and foreign (FDI grew threefold in from 1987 to 1988), inducing rapid GDP growth during this period, particularly in the manufacturing sector. In 1981, manufacturing accounted for only 11 per cent of Indonesia's total exports (25 billion US dollars), whereas in 1991 the same share had risen to 52 per cent.

7. Another noteworthy point in this development is that, as a result of these unilateral reforms towards more open and liberalized economy, Indonesia is not only more integrated into the global economy in general, but also now strongly linked to the region which spans from South-East to East Asia and in certain respects also reaches to North America. This integration process took place not only through increased foreign trade but also through integration of production process. The Indonesian economy is now meshed with the network of vertically integrated production processes which strongly bind the economies of the region.

Annex III
Statistical annex

Table A. Intra-regional and inter-regional trade, total trade

SITC 0-9 *millions of dollars (f.o.b.)*

Destination / *Origin*		World	DMEC	E.E. / Soc.A.	Developing countries					
					Total	America	Africa	West Asia	S. / S.E. Asia	Oceania
World										
	1970	311 905	218 158	32 282	59 137	18 617	11 836	7 059	17 779	738
	1980	2000 950	1335 990	166 797	481 202	126 105	84 367	96 520	150 725	2 994
	1986	2112 988	1442 988	212 263	439 368	97 984	60 525	80 428	175 693	3 147
	1987	2477 242	1727 898	219 162	500 395	104 817	63 161	83 788	222 716	3 394
	1988	2818 739	1964 200	244 107	582 561	114 127	68 673	87 821	284 041	4 093
	1989	3024 783	2128 590	231 711	638 896	124 311	70 460	91 461	322 462	4 639
	1990	3391 907	2429 663	199 713	715 950	132 109	81 938	101 501	369 602	5 036
	1991	3507 757	2461 732	205 478	795 517	154 821	81 987	115 501	419 991	5 116
Developed market economy countries										
	1970	222 557	169 993	8 403	42 726	13 887	9 093	4 831	12 299	633
	1980	1258 937	891 456	56 662	301 725	76 244	65 004	67 087	83 023	2 118
	1986	1471 372	1126 738	58 651	273 611	63 219	44 108	51 665	104 654	2 444
	1987	1735 501	1347 371	59 189	312 975	70 424	45 325	52 992	133 680	2 569
	1988	1984 402	1528 480	69 649	364 730	78 104	48 428	55 559	170 729	3 160
	1989	2129 317	1638 562	73 998	398 253	84 473	50 602	58 919	190 959	3 440
	1990	2445 208	1894 313	71 865	455 746	95 230	58 967	68 029	216 259	3 716
	1991	2506 899	1902 395	83 734	498 831	109 505	57 160	78 676	239 425	3 741
Eastern Europe and Socialist Asia										
	1970	32 830	7 711	..	5 170	1 030	1 147	882	1 263	..
	1980	175 493	52 129	..	37 061	5 541	5 496	6 831	9 344	..
	1986	224 159	51 249	122 668	48 332	8 483	4 570	6 386	16 677	16
	1987	242 283	57 695	126 206	56 688	8 728	5 634	7 567	21 620	18
	1988	257 445	63 800	131 065	62 383	8 869	5 797	7 249	27 247	..
	1989	250 471	73 444	110 370	65 245	8 652	4 554	6 289	31 735	..
	1990	237 752	87 705	80 073	67 095	9 040	4 228	5 444	38 018	27
	1991	251 129	102 045	71 723	75 407	11 636	4 064	6 748	46 857	28

(continue)

TABLE A. (cont.): total trade

Destination / *Origin*	World	DMEC	E.E. / Soc.A.	Developing countries					
				Total	America	Africa	West Asia	S. / S.E. Asia	Oceania
Developing countries									
Total									
1970	56 517	40 455	3 983	11 241	3 700	1 596	1 346	4 216	102
1980	566 520	392 405	24 559	142 416	44 321	13 867	22 602	58 358	846
1986	417 458	265 001	30 944	117 424	26 283	11 847	22 377	54 362	686
1987	499 459	322 831	33 767	130 731	25 665	12 202	23 229	67 416	807
1988	576 892	371 920	43 143	155 448	27 153	14 449	25 014	86 066	907
1989	644 995	416 585	47 344	175 398	31 186	15 303	26 253	99 769	1 170
1990	708 947	447 644	47 775	193 109	27 839	18 743	28 028	115 324	1 292
1991	749 729	457 291	50 021	221 280	33 680	20 763	30 077	133 708	1 347
America									
1970	17 513	12 932	1 127	3 401	3 029	119	37	148	8
1980	107 879	69 444	7 724	28 893	22 985	2 399	1 592	1 419	108
1986	86 045	56 095	8 365	20 829	14 903	1 706	1 606	2 373	12
1987	98 190	61 996	8 241	19 430	13 943	1 334	1 706	2 311	14
1988	109 758	75 673	9 244	22 235	14 714	1 755	1 826	3 713	28
1989	122 876	85 293	9 278	27 214	18 626	1 658	1 978	4 712	24
1990	133 596	83 892	7 603	27 444	18 174	1 948	2 109	4 915	32
1991	136 589	82 677	6 492	31 962	21 620	1 830	2 440	5 829	40
Africa									
1970	12 021	9 670	894	1 376	236	672	117	259	2
1980	94 942	78 737	2 783	12 629	5 879	2 978	1 801	1 130	1
1986	46 829	36 166	2 773	7 086	1 374	2 821	1 149	1 179	3
1987	49 666	40 103	1 941	7 031	1 312	3 007	1 157	1 155	7
1988	51 807	40 539	2 570	8 097	1 223	3 328	1 399	1 719	7
1989	56 331	44 744	2 612	8 281	756	3 865	1 708	1 505	3
1990	66 698	55 113	2 517	8 415	708	3 933	1 717	1 558	4
1991	65 267	52 957	2 296	8 740	562	3 925	1 723	1 837	6

(continue)

TABLE A. (cont.): total trade

Origin \ *Destination*	World	DMEC	E.E. / Soc.A.	Developing countries					
				Total	America	Africa	West Asia	S. / S.E. Asia	Oceania
Developing Countries									
West Asia									
1970	10 543	7 363	302	2 183	234	260	781	837	27
1980	210 976	150 989	3 640	53 215	11 745	3 524	11 120	25 709	112
1986	79 150	38 735	2 873	36 619	6 734	3 149	11 491	14 299	39
1987	84 579	44 670	2 803	36 187	6 549	3 021	11 589	14 253	33
1988	87 415	45 366	3 216	37 849	6 714	3 426	11 674	14 968	39
1989	100 233	55 916	4 077	39 075	6 307	3 131	12 220	16 578	44
1990	105 976	62 556	4 571	38 054	2 452	5 698	12 901	16 321	54
1991	99 569	59 422	2 622	35 605	2 501	6 127	11 339	15 196	58
South & South-East Asia									
1970	14 278	9 071	1 114	4 086	179	485	374	2 904	59
1980	141 561	88 020	6 230	45 937	3 642	4 229	7 461	29 878	539
1986	193 016	128 584	11 878	50 962	3 117	3 590	7 401	36 153	530
1987	253 280	168 733	16 719	65 742	3 698	4 194	8 015	49 067	612
1988	312 457	201 692	23 763	84 893	4 346	5 255	9 267	65 078	735
1989	349 008	221 356	26 643	98 325	5 263	5 953	9 506	76 406	933
1990	385 465	235 413	28 933	116 864	6 392	6 450	10 518	91 981	1 030
1991	440 295	256 870	37 998	143 890	8 983	8 710	14 306	110 368	1 093
Oceania									
1970	482	471	..	10	..	..	..	3	7
1980	2 184	1 930	..	198	6	..	..	109	83
1986	2 121	1 732	37	336	1	1	1	232	102
1987	2 347	1 768	38	530	1	1	1	385	141
1988	2 858	2 315	21	442	2	1	3	341	96
1989	3 184	2 571	50	531	3	..	2	360	165
1990	2 821	2 225	58	489	3	..	2	313	171
1991	3 304	2 549	64	586	4	1	1	429	150

Source: UNCTAD secretariat

Table B. Intra-regional and inter-regional trade, trade in manufacturing

STIC 5+6+7+8-68 *millions of dollars (f.o.b.)*

Origin \ *Destination*		World	DMEC	E.E. / Soc.A.	Developing countries					
					Total	America	Africa	West Asia	S. / S.E. Asia	Oceania
World										
	1970	189 913	128 490	20 573	39 947	12 873	8 887	4 920	11 074	476
	1980	1085 160	685 891	98 343	296 077	72 936	58 446	69 141	84 439	1 546
	1986	1428 031	997 100	132 784	291 607	62 670	41 271	57 919	118 067	1 957
	1987	1701 356	1220 080	136 090	336 163	70 130	42 914	58 797	152 622	2 130
	1988	1973 318	1408 221	155 042	398 857	78 842	46 484	62 626	196 255	2 621
	1989	2115 046	1514 233	143 447	448 189	85 851	49 185	63 995	235 380	3 030
	1990	2412 350	1752 139	129 190	518 225	96 472	56 772	72 178	275 930	3 198
Developed market economy countries										
	1970	160 352	119 512	6 233	33 608	11 327	7 357	3 769	9 094	431
	1980	892 668	612 490	38 862	239 104	60 595	49 362	55 635	65 293	1 350
	1986	1132 140	860 897	47 807	219 381	50 421	33 446	42 018	85 367	1 654
	1987	1338 493	1035 118	47 751	249 052	55 945	34 468	41 885	108 060	1 699
	1988	1534 986	1182 915	53 889	289 107	62 709	36 621	44 471	135 595	2 078
	1989	1639 364	1260 784	56 396	315 785	66 747	38 302	45 849	154 032	2 350
	1990	1907 567	1476 633	55 393	366 949	76 789	45 814	54 052	176 321	2 520
Eastern Europe and Socialist Asia										
	1970	19 106	2 762	13 381	2 939	636	768	718	775	2
	1980	87 416	14 227	52 972	18 631	3 168	3 881	4 487	4 446	18
	1986	114 690	19 362	70 497	23 376	4 287	2 778	4 610	8 504	16
	1987	117 434	20 631	70 780	24 722	4 341	2 820	4 493	10 565	15
	1988	131 830	25 932	76 393	28 768	4 694	2 788	4 459	12 519	22
	1989	130 274	31 095	60 328	37 868	4 863	3 022	4 163	23 728	21
	1990	122 149	34 691	44 283	42 079	4 835	2 469	3 259	29 800	20

(continue)

TABLE B. (cont.): manufacturing trade

Destination / *Origin*	World	DMEC	E.E. / Soc.A.	Developing countries					
				Total	America	Africa	West Asia	S. / S.E. Asia	Oceania
Developing countries									
Total									
1970	10 455	6 212	957	3 402	774	23	2	20	0
1980	105 077	59 173	6 509	38 341	6 987	669	271	236	7
1986	181 202	116 841	14 480	48 851	7 961	5 047	11 290	24 196	287
1987	245 429	164 331	17 558	62 389	9 844	5 626	12 419	33 996	416
1988	306 503	199 374	24 760	80 982	7 651	792	586	2 051	16
1989	345 409	222 354	26 723	94 536	9 448	827	664	2 515	10
1990	382 634	240 815	29 513	109 196	9 127	826	662	2 409	18
America									
1970	1 855	1 005	27	821	484	21	1	18	0
1980	15 880	7 308	356	8 192	5 702	663	270	231	7
1986	20 963	12 613	953	7 340	5 326	657	472	867	3
1987	28 405	19 044	679	8 650	6 458	564	594	1 022	5
1988	36 139	23 881	1 134	11 107	6 925	771	577	2 029	16
1989	40 997	26 498	983	13 482	8 410	803	652	2 464	10
1990	41 165	27 359	671	13 067	8 186	781	639	2 366	18
Africa									
1970	841	475	150	373	8	323	30	11	0
1980	3 821	2 535	232	949	46	564	101	227	0
1986	5 252	3 113	389	1 696	72	941	294	367	1
1987	6 171	4 032	393	1 690	118	928	264	353	0
1988	7 823	4 842	646	2 244	85	1 117	368	647	0
1989	8 818	5 930	509	2 298	59	1 294	519	408	0
1990	10 070	6 936	489	2 547	73	1 279	622	542	1

(continue)

TABLE B. (cont.): manufacturing trade

Destination / *Origin*	World	DMEC	E.E. / Soc.A.	Developing countries					
				Total	America	Africa	West Asia	S. / S.E. Asia	Oceania
Developing countries									
West Asia									
1970	464	144	42	236	2	37	175	17	0
1980	6 422	2 219	216	3 846	17	337	3 179	305	0
1986	10 135	3 784	437	5 848	11	590	4 630	606	0
1987	12 883	5 929	537	6 363	24	613	4 973	737	0
1988	13 840	6 130	774	6 888	29	835	4 985	1 014	0
1989	16 354	7 809	1 773	6 715	25	787	4 898	968	0
1990	20 119	10 269	2 326	7 407	44	956	4 842	1 477	2
South & South-East Asia									
1970	6 208	4 066	339	1 804	107	332	192	1 094	39
1980	72 153	44 872	2 413	24 084	2 079	3 030	4 954	13 843	150
1986	136 273	94 546	8 354	32 519	2 418	2 369	5 256	22 212	241
1987	188 809	131 296	12 441	44 062	3 106	2 969	5 969	31 627	354
1988	238 434	159 731	18 452	59 022	3 555	3 757	7 022	44 182	461
1989	268 170	176 764	19 528	70 254	4 486	4 395	7 214	53 486	575
1990	299 704	189 755	22 661	84 480	5 508	4 856	8 069	65 094	566
Oceania									
1970	84	81	0	3	0	0	0	1	3
1980	268	237	0	30	1	0	0	10	19
1986	279	203	0	76	0	1	0	34	42
1987	250	154	0	96	0	1	0	39	57
1988	489	406	0	80	0	0	0	38	41
1989	693	538	1	153	0	0	0	81	72
1990	542	370	1	155	1	0	0	84	69

Source: UNCTAD secretariat

Table C. Growth, trade and diversification

	GDP growth	*Export growth*	*Three products*	*Petro. exporter*
Sub-Saharan Africa				
Angola	6.4	6.2	97.49	Yes
Burundi	4.4	2.9	91.92	No
Burkina Faso	4.2	7.4	82.22	No
Cameroon	2.3	1.6	40.22	No
Central Africa	1.7	1.9	79.66	No
Chad	6.4	10.4	67.53	No
Congo	3.5	-2.7	90.92	Yes
Côte d'Ivoire	0.6	2.3	57.75	No
Gabon	0.0	-3.3	90.61	Yes
Ghana	3.0	1.6	68.11	No
Guinea	-1.1	0.7	95.29	No
Kenya	4.2	-1.7	55.37	No
Liberia	-2.8	-3.9	73.80	No
Malawi	2.8	2.3	85.95	No
Mali	3.1	6.6	79.78	No
Mauritania	1.7	6.6	93.28	No
Mauritius	6.3	14.6	60.03	No
Niger	-1.3	-5.4	95.78	No
Nigeria	1.6	-8.7	98.08	Yes
Rwanda	1.0	-0.3	90.71	No
Senegal	3.1	3.0	39.25	No
Sierra Leone	0.9	-0.9	53.42	No
Togo	1.6	1.4	74.80	No
Uganda	4.2	-4.4	95.64	No
United Republic of Tanzania	2.8	-4.8	49.42	No
Zaire	1.7	1.7	82.65	No
Zambia	0.8	-0.3	86.01	No
Zimbabwe	3.4	1.9	42.02	No
West Asia and North Africa				
Algeria	2.5	-4.8	95.99	Yes
Bahrain	10.6	-3.2	84.32	Yes
Cyprus	2.1	5.0	37.37	No
Egypt	5.0	-3.7	45.45	No
Iraq	11.7	-5.9	85.14	Yes
Islamic Republic of Iran	2.7	-3.8	95.27	Yes
Jordan	7.0	-3.8	57.96	No
Kuwait	-0.8	-7.1	74.36	Yes
Libyan Arab Jamahiriya	-4.1	-9.9	94.65	Yes
Morocco	4.2	6.3	26.68	No
Saudi Arabia	10.6	-13.5	87.50	Yes
Sudan	0.9	-0.8	64.53	No
Syrian Arab Republic	9.6	2.2	67.54	Yes
Tunisia	3.5	3.5	38.53	No
Turkey	5.6	14.0	17.94	No

(continue)

Table C. (cont.): Growth, trade and diversification

	GDP growth	*Export growth*	*Three products*	*Petro. exporter*
South to East Asia, Pacific				
Bangladesh	4.3	9.8	42.70	No
Fiji	1.4	3.5	61.77	No
Hong Kong	7.0	16.8	26.77	No
India	5.8	7.5	26.80	No
Indonesia	4.6	-1.3	47.86	Yes
Malaysia	5.3	8.6	33.70	No
Nepal	4.7	8.2	80.26	No
Pakistan	6.3	8.1	39.10	No
Papua New Guinea	1.9	4.5	73.72	No
Philippines	0.9	3.8	31.67	No
Republic of Korea	9.7	15.1	18.34	No
Samoa	1.1	-3.1	54.10	No
Singapore	6.5	9.9	35.46	No
Sri Lanka	2.2	5.6	47.50	No
Taiwan province of China	8.2	14.8	14.88	No
Thailand	7.5	14.0	15.77	No
America				
Argentina	-0.3	2.1	26.75	No
Barbados	2.3	-8.2	46.20	No
Bolivia	-0.4	-3.3	58.60	No
Brazil	2.7	5.1	18.26	No
Chile	3.2	8.2	56.10	No
Colombia	3.6	7.7	52.98	No
Costa Rica	3.0	4.1	50.92	No
Dominican Rep.	2.0	-2.1	69.12	No
Ecuador	2.0	-0.5	75.16	Yes
El Salvador	0.6	-6.6	53.62	No
Guatemala	0.8	-2.0	47.28	No
Guyana	-2.2	-2.9	71.18	No
Haiti	-0.6	-0.9	28.61	No
Honduras	2.7	1.9	69.26	No
Jamaica	1.6	1.0	74.24	No
Mexico	0.9	2.4	46.19	No
Nicaragua	-2.3	-7.0	54.41	No
Panama	0.3	-0.4	56.79	No
Paraguay	2.7	13.0	77.31	No
Peru	-0.3	-1.5	46.88	No
Uruguay	1.0	4.5	40.43	No
Venezuela	1.1	-4.6	83.68	Yes

Source: UNCTAD secretariat

GDP growth = Growth rate of total per capita gross domestic product
1980-1990 annual average, percentage, market prices

Export growth = Growth rate of value exports
1980-1990 annual average, percentage, f.o.b.. prices

Three products = Share of three most exported products in total exports
(SITC Rev.2, 3-digit level), 1989-1990 average, percentage

Petro. exporter = Whether or not the country is a major petroleum exporter